

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BELL SOUTH)	
TELECOMMUNICATIONS, INC. D/B/A)	
South Central Bell TELEPHONE COMPANY)	CASE NO. 94-121
TO MODIFY ITS METHOD OF REGULATION)	

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O R D E R

BACKGROUND

On March 30, 1994, BellSouth Telecommunications, Inc. d/b/a South Central Bell Telephone Company ("South Central Bell" or "Company") filed an application seeking approval of a price regulation plan. AT&T Communications of the South Central States, Inc. ("AT&T"), MCI Telecommunications Corporation Southeast Division ("MCI"), LDDS Communications, Inc. d/b/a LDDS Metromedia Communications ("LDDS"), Sprint Communications Company L.P. Southeast Division ("Sprint"), GTE Mobilnet/Contel Cellular, Inc. d/b/a Contel Cellular of Kentucky ("Contel Cellular"), and the Attorney General, by and through his Public Service Litigation Branch, ("AG") have all intervened. A public hearing began on April 18, 1995 and concluded April 21, 1995.

OVERVIEW

Pursuant to KRS 278.512, the Commission has approved a price cap plan for South Central Bell. Given the present landscape of the telecommunications industry, the Commission has concluded in this instance that a price cap plan with the features approved is

superior to rate of return regulation and thus is in the public interest.

The telecommunications industry is in rapid transition on all fronts due to technological changes and market forces. In responding to these market changes, South Central Bell has made great strides in increasing its efficiency and productivity. However, many segments of its markets remain monopolistic. To allow it the flexibility to be a viable competitor while retaining the benefits of increased productivity for the still captive ratepayers, a new model of regulation must be implemented. Price cap regulation with proper safeguards is the form of regulation best suited to South Central Bell during this period of market transition.

This Order establishes measures to avoid cross subsidization among competitive and noncompetitive services and requires an initial reduction in rates of approximately \$29 million. Local residential rates are capped for a minimum of three years and longer if needed to establish a viable universal service fund to assure continued affordable residential service. To foster competition in the toll market, access charges may not exceed Federal Communications Commission ("FCC") interstate rates. South Central Bell will be required to maintain its service quality in all areas, rural and urban, and provide detailed reporting concerning its service objectives.

The formula for pricing noncompetitive services includes a 4 percent productivity factor. This level of productivity or growth

in the factors of production, is achievable and including it in the pricing formula should encourage the Company to be as efficient as possible. That level of performance may well translate into lower prices for consumers.

In all areas, the regulatory process has been streamlined to afford South Central Bell the ability to alter prices and conditions of service expeditiously. The Commission retains full jurisdiction and will act swiftly to remedy any abuses.

Overall, this plan provides the best possible set of conditions to protect the ratepayers and to allow South Central Bell to remain a viable entity in the rapidly changing telecommunications industry.

JUSTIFICATION OF PRICE CAP REGULATION

KRS 278.512(2) allows the Commission to approve an alternate form of regulation for telecommunications utilities.¹ However, the regulatory change must be found to be in the public interest.

South Central Bell faces pressures from competitive access providers ("CAP"), cable television providers ("CATV"), and wireless communications providers such as cellular and personal communications services ("PCS"). The Company notes that the FCC de

¹ KRS 278.512(2) states, "[T]he Commission ... may exempt to the extent that it deems reasonable, services or products related to telecommunications utilities or persons who provide telecommunications services or products from any or all of the provisions of this chapter, or may adopt alternative requirements for establishing rates and charges for any service by a method other than that which is specified in this chapter, if the Commission finds by clear and satisfactory evidence that it is in the public interest."

minimis rule will allow a CAP to provide up to 89 percent of its service in the intrastate market and remain outside Kentucky's jurisdiction. Technological advances such as digital compression, interactive video, multimedia, and energy management are enabling CATV, CAPs, interexchange carriers ("IXC"), and power companies to upgrade their networks with fiber and hybrid fiber/coax architectures. With their advanced networks, these companies will be able to offer a full range of services to telecommunications customers. Increasingly, streamlined regulatory oversight is allowing unregulated firms, such as the Glasgow Electric Plant Board, to enter regulated markets. Mergers between IXCs and wireless companies are allowing IXCs to enter local markets.²

South Central Bell argues that its plan will allow it the necessary flexibility to meet its competitive challenges. In return, it would assume the risk of managing its business in an increasingly competitive marketplace.³ By placing a ceiling on basic residential service, the plan would shift risk from customers to shareholders and assure available and affordable basic service.⁴

The plan contains price constraints in each of three service categories but requires most prices to remain above long run incremental cost. Under the proposal, the monitoring process

² See Margaret H. Greene Testimony dated March 30, 1994 at 3-11 and Charles L. Jackson Testimony dated March 30, 1994 at 6-27.

³ See South Central Bell's response to PSC hearing request dated June 2, 1995, Item 2.

⁴ Greene Testimony at 3.

established under incentive regulation would also continue. The plan calls for shorter review periods for price changes, new service introductions, and changes in service categories. Finally, South Central Bell argues that it is not necessary to meet the criteria listed in KRS 278.512(3) to find its plan in the public interest. Nonetheless, the Company argues that it has satisfied all requirements of the statute.⁵

AT&T opposes South Central Bell's plan. It asserts that South Central Bell's switched access rates are so high, even at interstate levels, that they are detrimental to consumers and to the introduction of competitive communications options in Kentucky, and that South Central Bell's pricing rules will not move its rates toward the cost of service. AT&T urges elimination of non-traffic sensitive rate elements, the residual interconnection charge, and the traffic sensitive recovery of line termination costs,⁶ arguing that the plan, once accepted, will greatly hinder the Commission's ability to broaden or protect competition.⁷ AT&T opines that the proposed plan contains far too much pricing flexibility between services, thereby threatening cross subsidization of services and discriminatory pricing.

AT&T also states that the plan does not satisfy the provisions of KRS 278.512 and, in supplemental testimony, offered an

⁵ See South Central Bell Brief at 17-19.

⁶ G. Michael Harper Testimony, dated August 29, 1994 at 2-3.

⁷ Id. at 6.

alternative plan.⁸ It considers South Central Bell's proposed pricing flexibility to be extreme and argues that there is not sufficient competition in the marketplace effectively to constrain South Central Bell.

AT&T, Sprint, and LDDS ("IXC Coalition") argued that current market conditions do not warrant the introduction of a price cap system and raised several issues, primarily regarding South Central Bell's interconnection service category. The IXC Coalition argued that the plan has no systematic mechanism to adjust access rate levels toward cost and that limiting access rate increases to the level of inflation ignores falling costs, due to advances in technology and productivity. Discrimination between access customers would be facilitated through non-cost based volume discounts and plans rewarding growth. Also, discriminatory dialing patterns and the absence of basic competitive protections, such as imputation of costs and price floors, are significant barriers to effective competition in the interexchange market. Finally, the coalition suggests that competition in the switched access and local exchange markets has not yet begun.⁹ MCI emphasized many of the same positions.

⁸ See G. Wayne Ellison Testimony dated August 29, 1994 and Supplemental Testimony dated March 20, 1995, respectively.

⁹ See Joseph Gillan Testimony dated August 29, 1994 at 4 and 6-16.

The AG argues that South Central Bell's proposed plan is not in the public interest.¹⁰ Generally, he maintains that the Company has not demonstrated the need for the plan and that pricing flexibility could be accomplished under traditional rate of return regulation.¹¹ The AG asserts that South Central Bell faces no effective competition, other than in a few niche and specific service markets, that the plan lacks adequate safeguards to protect customers from abuses, and that the lack of dialing parity inhibits entry into the intraLATA market. He opposes allowing the Company to retain increased earnings, regardless of changes in realized productivity or efficiency.¹²

The AG argues that South Central Bell's base rates are not cost based and asserts that non-competitive service rates are excessive and should be established after an earnings review.¹³ Finally, he criticizes the proposed service categories. They are not based upon competitive market characteristics, the productivity

¹⁰ See generally, Marvin H. Kahn Testimony dated August 29, 1994 at 24-43.

¹¹ See Mark N. Cooper Testimony dated August 29, 1994 at 6 and Kahn Testimony at 12.

¹² See Cooper Testimony at 5-6, Transcript of Evidence ("T.E."), Vol. IV at 94-5, and Kahn Testimony at 4, 15, and 25-7, respectively.

¹³ See generally, Kahn Testimony at 10-11 for examples of earnings reviews in other states and Matthew I. Kahal Testimony dated August 29, 1994 concerning South Central Bell's rate of return.

offset applies only to "Basic" services, and there is no effective cap on rate increases for "Non-Basic" services.¹⁴

KRS 278.512(3)(a)-(i) list factors which must be considered by the Commission before it approves an alternate form of regulation. KRS 278.512(3)(a)-(c) concern the extent to which competition exists in the relevant markets. The record indicates that South Central Bell is facing competition for some of its services which will increase with future technological advances and relaxed regulatory oversight. The Company emphasizes that competition for high-volume customers could severely affect its profitability. It notes that one percent of its Louisville business customers produce 30 percent of its statewide business revenue. This statistic illustrates the magnitude of risk the Company will assume under price regulation.¹⁵ However, the record also shows that the market cannot act as an effective constraint on the Company's ability to set certain of its own prices. It remains possible for South Central Bell to engage in price discrimination and cross subsidization between services in different markets.

KRS 278.512(3)(d) and (f) address just and reasonable rates and universal service. The intervenors expressed concerns over South Central Bell's ability, through the plan's pricing flexibility, to cross subsidize services, engage in discriminatory pricing, and hamper the development of fully competitive markets.

¹⁴ See Kahn Testimony at 24-25.

¹⁵ See South Central Bell Brief at 23.

While the Commission shares these concerns, the plan as approved should protect consumers, competitors, and the Company. KRS 278.512(3)(g) relates to the ability of a regulated utility to compete with unregulated providers of functionally similar services or products. A well crafted price cap plan will contain the proper safeguards to assure just and reasonable rates and allow South Central Bell to respond to competition, without endangering universal service.

The Commission finds that implementing a price cap form of regulation for South Central Bell is appropriate with the safeguards it has included and will provide added incentive for the Company to operate its business efficiently. The plan protects captive ratepayers and assures that productivity increases will flow to them. The plan assures that customers will receive high quality service. The plan adequately addresses intervenor concerns, satisfies the criteria set out in KRS 278.512(3), and is in the public interest.

INITIAL RATE REDUCTION

Although South Central Bell maintains that its current rates are fair, just, and reasonable, it proposed immediate revenue reductions totalling \$14 million, consisting of a \$10 million reduction in intrastate access charges and a \$4 million reduction in touch-tone charges. It proposes additional touch-tone reductions of \$4 million in 1997 and \$4 million in 1999, for total revenue reductions of \$22 million. The AG proposed an initial \$43 million reduction retroactive to June 1, 1994, because South

Central Bell's previous Incentive Regulation Plan expired on May 31, 1994. He also proposed future reductions based on anticipated staff reductions within the Company. The AG's proposal assumed an 11.5 percent return on equity and an overall return on capital applied to a net investment rate base of \$750.9 million.

Given the significance of the change from rate-of-return regulation to price cap regulation, it is critical to establish appropriate earnings at the outset. To achieve appropriate earnings at this time, South Central Bell's revenues should be reduced immediately by \$28.9 million based upon a return on equity of 12.5 percent. Consistent with longstanding regulatory policy, this reduction will be prospective. Also, it is inappropriate to order future rate reductions based upon projected staff reductions at the beginning of price regulation as the effects of these actions, if they occur, will be incorporated in the Company's productivity factor. The detailed basis for the immediate reduction of \$28.9 million and the specific rates reduced follow at the conclusion of this Order.

SERVICE CATEGORIES

Within a price cap plan, individual services are grouped into categories and priced to protect customers from cross subsidization and price discrimination. The pricing structure governing each category is designed to allow customers to share the benefits of increased productivity and efficiency, and to allow the Company the necessary pricing flexibility to compete in the marketplace.

South Central Bell has proposed three service categories: "Basic," "Interconnection," and "Non-Basic." As it describes them, Basic services are those required to provide basic local exchange service for which the customers have limited substitutes. These services traditionally have been residually priced and have the least pricing flexibility.

Interconnection services include access services. Typically, these are wholesale services sold to IXCs rather than retail customers. South Central Bell's pricing flexibility will be somewhat limited for these services. Non-Basic services are all others not classified as either Basic or Interconnection services.¹⁶

AT&T proposed alternative service categories¹⁷ with each of South Central Bell's non-competitive services in its own category. AT&T argues that its nine categories are necessary to prevent anticompetitive pricing.¹⁸

Intervenor arguments concerning South Central Bell's ability to cross subsidize services, given the services in its three categories, are well taken. While the Company faces varying degrees of competition for services in its Interconnection and Non-Basic categories, the market does not yet fully constrain South Central Bell's ability to set its own prices for many of these

¹⁶ Fred L. Gerwing Testimony dated March 30, 1994, Exhibit FLG-1 at 2 of 20.

¹⁷ Ellison Supplemental Testimony 2-7.

¹⁸ Id. at 5-6.

services. Commingling services which face varying degrees of competition could facilitate anticompetitive pricing. However, as stated by South Central Bell,¹⁹ AT&T's nine service categories would be administratively burdensome and would unnecessarily constrain pricing flexibility.

The three service categories described below will sufficiently deter cross subsidy and promote flexibility. A "Non-Competitive Service" category will contain those services, products, and options which are commonly included in basic local exchange service packages. For the vast majority of these services, South Central Bell does not yet face effective competition. An "Interconnection Service" category will contain those interconnection and access services commonly purchased by other telecommunications providers. A "Competitive Service" category will contain those services not contained in the other categories. South Central Bell presently faces effective competition for these services. A list of services in each category is included in Appendix A.

Non-Competitive Services

South Central Bell Proposal. For its Basic Services category, South Central Bell proposed to freeze the basic residential individual line service rates for a period of three years. All other basic services would be subject to a price ceiling defined by an inflation index, adjusted by the annual change in the United States Department of Commerce's Gross Domestic Product Price Index

¹⁹ William E. Taylor Testimony dated April 19, 1995 at 21.

("GDP-PI"). These rates could be changed at any time as long as the changes did not exceed the Basic Category Price Regulation Index ("PRI") which would be used to determine the maximum price change for a 12-month period. The PRI would be calculated using the GDP-PI with an inflation threshold of 3.3 percent. The PRI would change based on the following scale:

<u>GDP-PI</u>	<u>PRI Change</u>
0 - 3.30%	0%
3.31 - 5.00%	equal to the GDP-PI
5.01% - 10.00%	5.00%
greater than 10.00%	$5.00\% + (\text{GDP-PI} - 10.00)/2$

South Central Bell would track price changes using a Service Price Index ("SPI"), a category related index. Each service in the Basic category would be demand weighted within the index, so that the greater the demand for a service relative to other services, the larger the effect a price change for that service would have on the SPI value. Individual service prices could change at any time as long as the resulting SPI was less than or equal to the PRI. If a rate change were filed with the Commission, the Company would provide a new SPI calculation and the rationale for the change. At each annual filing date, new PRI calculations would use annualized December figures for access line and usage demand. Non-recurring demand figures would be the actual 12-month demand.

Price changes would become effective upon 30 days notice to the Commission and a showing that the pricing rules had not been violated, unless the tariff was suspended. The Company could defer allowable price increases and increase prices in subsequent years

if the SPI did not exceed its contemporaneous PRI ceiling. Any revenues forgone by deferring increases would not be recovered.²⁰

Intervenor Proposals. AT&T proposed three general pricing rules to apply to all service categories: a maximum category price, a minimum service price, and a maximum rate increase. The maximum pricing rule would limit the annual growth of category revenues resulting from price increases. The initial maximum category value would be calculated as the total price for a "shopping list" of the services. The "shopping list" would consist of the prior year's demand for services in each category. Thereafter, increases could not cause the "shopping list price" to exceed its price in effect when the plan is implemented. The maximum category value would be recalculated annually using prior year demand, initial rates, and an annual price adjustment (productivity) factor. This is analogous to South Central Bell's service category PRI and SPI values. Productivity factors would vary according to individual category characteristics. AT&T did not propose specific factors, but recommended that South Central Bell be required to calculate them and then submit them for intervenor comment.²¹

AT&T's minimum price rule would require South Central Bell to price each retail service at levels which recover, at a minimum, the tariffed rates of included basic network functions plus additional specific costs of that service. The Company would be

²⁰ Gerwing Testimony Exhibit FLG-1 at 5-8 of 20.

²¹ Ellison Supplemental Testimony at 7-10.

required to reprice each of its basic network functions at cost based rates and eliminate current subsidies. All basic network components could be resold publicly at filed rates.²²

Under AT&T's maximum rate increase rule, individual service rate increases would be limited to predetermined annual levels. Annual increases could not exceed 5 percent for basic and basic network services, 15 percent for consumer transport services, and 10 percent for other retail services.²³

The AG did not propose a specific pricing mechanism but recommended a productivity offset of 5 to 7 percent for South Central Bell's Basic service category.²⁴

Neither the IXC Coalition nor MCI proposed a specific pricing mechanism but argued that South Central Bell should not be allowed to price its services below cost. MCI proposed Total Service Long Run Incremental Cost ("TSLRIC") rather than Long Run Incremental Cost ("LRIC") as the correct pricing standard. MCI defines ". . . TSLRIC as the difference between the total cost of providing all of a local exchange carrier's services (including the service in question) and the total cost of providing all such services except for the specific service in question. It represents the

²² Id. at 12.

²³ Id.

²⁴ Kahn at 30 and generally at 17-23, 28-41 with Exhibits and Supplemental Testimony dated April 5, 1995. South Central Bell's witness Taylor was the only other witness to recommend a specific productivity offset. He criticized Kahn's methodology and recommended a productivity offset in the 2 percent range. See Taylor Testimony at 2.

incremental cost of providing the entire quantity of a specific service."²⁵ The IXC Coalition proposed a conceptually similar approach applicable to setting minimum prices for noncompetitive services.²⁶

Inflation Offset. South Central Bell's proposal employs an inflation offset to limit allowable price increases as measured by the percent change in the PRI. Under most price cap plans, if a productivity factor exceeds the GDP-PI in a given year, decreases are required. For inflation levels below 3.3 percent, South Central Bell proposed to hold prices steady for services in its Basic category.²⁷ When asked why an inflation offset was used in its pricing formula rather than a productivity factor, South Central Bell stated that a productivity factor above the GDP-PI could cause it to alter local exchange prices and that it was not sensible to lower prices on services which were already priced

²⁵ Randy R. Klaus Testimony dated August 29, 1994, at 21-23. Attachment 2 to Klaus' Testimony discusses the theory and application of MCI's building blocks methodology.

²⁶ Gillan Testimony at 12-14.

²⁷ South Central Bell further argued that freezing residential rates for three years enhanced its inflation threshold, thus providing additional protection to residential ratepayers. South Central Bell Brief at 8-9 and T.E. at Vol. IV 181-2. Intervenor's argued that freezing local rates in a period of declining costs would deprive ratepayers of potential rate decreases and grant additional revenues to South Central Bell. Kahn Testimony at 29, 34-6, and Exhibit MHK-3, Klaus Testimony at 10, MCI Brief at 18, AT&T Brief at 6. Also see T.E. at Vol. II, 411-412 and Vol III, 33-34. South Central Bell witness Taylor argued that costs were not declining. See Taylor Testimony, Section II, and T.E., Vol IV at 161-3 and 189.

below cost.²⁸ While maintaining that its inflation offset was not a productivity offset, the Company supported the offset using productivity analyses.²⁹

The use and nature of productivity offsets in price cap formulas have been thoroughly discussed and accepted at the federal level³⁰ and in intervenor testimony.³¹ South Central Bell filed information concerning price cap plans implemented in other states and a comparison of its plan and those adopted in other states where BellSouth does business.³²

The FCC's recently revised price cap plan³³ allows Local Exchange Carriers ("LECs") to choose from among three levels of productivity, ranging from 4.0 percent to 5.3 percent. LECs choosing the 5.3 percent productivity offset are not required to share earnings with their customers. South Central Bell has chosen the 5.3 percent level, indicating that it expects to be able to achieve this level of productivity in the interstate markets.

²⁸ T.E., Vol. II at 23, and 261-262.

²⁹ South Central Bell Brief at 9-10.

³⁰ See generally, Policy and Rules Concerning Rates for Dominant Carriers FCC October 4, 1990 Docket No. 87-113, Second Report and Order, 5 F.C.C. Record 6, 786.

³¹ For example, see Klaus Testimony at 11-13 and Kahn at 17-23, 28-41 with Exhibits and Supplemental Testimony dated April 5, 1995 and Taylor Testimony.

³² See South Central Bell responses to Commission Orders dated May 11, 1994, Item 5, August 5, 1994, Items 1,7,8, and 12, and its response to PSC hearing request, filed May 11, 1995.

³³ Price Cap Performance for Local Exchange Carriers FCC March 30, 1995 CC-Docket No. 94-1, First Report and Order.

However, it argued that using this level in the intrastate market would be inappropriate because intrastate markets have not received the same productivity enhancing investment as the interstate market.³⁴

Productivity Factor and Pricing Formula. The use of inflation offsets in price cap formulas is designed to reflect productivity increases. South Central Bell's only argument, that it should not be forced to reduce service prices which were already below cost, is not sufficient to obviate the need for designating and treating its inflation offset as a productivity factor.

Throughout this proceeding, intervenors have argued that costs are declining in the telephone industry due to technological innovation and increasing productivity and efficiency. South Central Bell states that its costs are not declining and that intrastate markets are not experiencing significant productivity gains regardless of events in the interstate markets.

The record supports the conclusion that the telecommunications industry should experience lower costs in the future due to increased productivity and efficiency in the interstate and intrastate markets. Although South Central Bell has forcefully argued that it is facing increasing competition, the Commission is confident that the Company will continue to increase its productivity and efficiency as it has done under its Incentive Regulation Plan. A 4 percent productivity factor will provide

³⁴ T.E., Vol. I at 49, 55-56, and Vol. IV, 257-8.

South Central Bell with the incentive to manage its business efficiently. It will also allow captive customers to enjoy the benefits of the Company's productivity and protect them from potential abuses of market power during the transition to fully competitive markets.

The GDP-PI is an appropriate inflation measure to which no party objected and it will be used in the Commission's pricing formula which adopts South Central Bell's general pricing formula, with certain changes. At inflation rates between 0 percent and 8 percent, the PRI will equal the inflation rate minus the productivity factor. At inflation rates greater than 8 percent, the PRI will equal one half the inflation rate. This formula is illustrated below.

<u>GDP-PI</u>	<u>PRI Change</u>
0 - 8.0%	GDP-PI - 4.0%
greater than 8.0%	(GDP-PI)/2

The Commission will also accept South Central Bell's proposed timing for recalibrating the PRI. The SPI should never exceed its contemporaneous PRI and the annual price increase of an individual service offering should never exceed 10 percent. With these changes, South Central Bell's annual filing proposal and schedules, as provided in Gerwing Testimony, Exhibit FLG-1, Schedule 2, should be accepted with the filing and effective dates deferred two months respectively.

South Central Bell's plan would permit it to defer allowable, but not taken, price increases, measured by the percent change in

the PRI.³⁵ It stated that without this flexibility, it would be forced to implement all allowable price increases.³⁶

Such action would be logical, as it is easier to lower prices than to raise them under the plan. Firms operating in competitive markets may increase prices at any time the market allows. If price increases prove unsustainable, prices may be lowered to levels defined by the market. As South Central Bell experiences increasing competitive pressure, increasing prices in the local market will only serve to encourage competitors to enter.

Nonetheless, the Commission finds that, within any year, the Company should be allowed to implement any permitted price increases, but should not be allowed to defer them to future years. The risk of rate shock is too great to allow accumulating deferrals at the present level of competition.

Within any year, all decreases must be implemented. When the PRI requires a price decrease, the SPI should be lowered to the appropriate level prior to the PRI anniversary date. When a price increase is warranted, the SPI should be raised to the PRI value prior to the PRI anniversary date. If the SPI is not equal to the PRI, the recalibrated PRI value should be set at the current SPI value. In other words, warranted price decreases must be implemented immediately upon PRI recalibration and any allowable

³⁵ AT&T's price cap proposal also contained a carryover provision. See Ellison Supplemental Testimony, Section D at 9.

³⁶ See T.E., Vol. II at 275.

price increases must be implemented in the year they are allowed or be forfeited. The SPI and PRI values must be equalized on each anniversary date.

The total service long-run incremental cost approach proposed by MCI is not adopted. South Central Bell's accounting and costing systems do not incorporate TSLRIC standards. To require an abrupt change in methodologies at this time would be unduly burdensome. TSLRIC is not used at the federal level in matters concerning illegal pricing and has not been widely adopted by other regulatory authorities. Instead, South Central Bell should be required to show by cost study that any price it proposes to change covers its long-run incremental cost for that service if the price was not already below that cost on the date of this order. Until a fully competitive market exists to adjust prices to cost, the Commission must continue to act in lieu of market forces.

Finally, universal availability of service must not be compromised. Pricing based on value of service, long a hallmark of the telecommunications industry, recognized that without universality, the concept of telecommunications service is seriously weakened. The value of the network lies in all persons having access to a telephone at an affordable rate. To protect this value, South Central Bell's proposed three year cap on local residential rates should be accepted and continued thereafter until a viable and equitable universal service fund is implemented.³⁷

³⁷ KRS 278.512(3)(1).

Interconnection Services

South Central Bell proposed to reduce its intrastate switched access rates to the FCC interstate level as of December 1, 1994. Thereafter, allowable price increases would be limited to increases in the GDP-PI. Unless the Commission suspended tariffs, rate changes would become effective upon 30 days notice to the Commission.³⁸

South Central Bell presently holds a monopoly position for IXC access to the switched network. Thus, it can manipulate the toll market through its pricing of these services. To assure that South Central Bell does not abuse this market power, it should be limited to the FCC rates for all intrastate switched access services it has in common with the interstate services. For services for which there is no interstate counterpart, the pricing formulas set out in the "Non-Competitive" category should apply. While the Company may offer rates lower than the FCC's or those allowable under the noncompetitive model, all price changes must be accompanied by a cost study and must cover long-run incremental cost.

Competitive Services

For its Non-Basic services, South Central Bell seeks full discretion to set the rates, terms, and conditions based upon its assessment of market conditions. No rate could be raised more than 20 percent in one year, unless a penny increase would be greater than 20 percent. Rate changes could become effective upon 30 days

³⁸ Gerwing Testimony Exhibit FLG-1 at 7 of 20.

notice to the Commission, unless suspended. The rules for suspension and review for new services would similarly apply. Cost-of-service studies would be provided as required.³⁹

South Central Bell's Non-Basic category contained all services not included in its Basic and Interconnection categories. Describing them as either highly discretionary or competitive, South Central Bell seeks maximum pricing flexibility for these services.⁴⁰ However, only services subject to significant competition should be placed in this category. Only where significant competition exists can the market act as an effective constraint on South Central Bell's ability to establish its prices arbitrarily. By the same token, where significant competition exists, there is no need to impose the maximum 20 percent increase rule. Moreover, pricing constraints on services in the other categories will protect customers of those services from subsidizing the prices charged for services in the Competitive category. Cost studies will be required for all price changes in the Competitive category. No limit on price changes for services in the Competitive category will be required.

Long-Run Incremental Cost Constraints

South Central Bell proposes to maintain its prices above the long-run incremental cost of the related services, except when responding to a competitor's pricing challenge. MCI and AT&T argue

³⁹ Id. at 8 of 20.

⁴⁰ South Central Bell Brief at 6.

that this exception would allow predatory pricing which, according to MCI, is illegal.⁴¹ South Central Bell maintains that it is lawful and appropriate to price a service below cost when meeting a pricing challenge from a competitor.⁴²

South Central Bell argues that meeting competition is an affirmative defense to a claim of unlawful price discrimination under the Robinson-Patman Act which addresses federal price discrimination (Section 2b) and to a predatory pricing claim under Section 2 of the Sherman Act. In Richter Concrete Corp. v. Hilltop Concrete Corp., 691 F.2d 818, 826 (6th Cir. 1982), the court, quoting from ILC Peripherals v. International Business Machines Corp., 458 F.Supp. 423, 433 (N.D.Cal.1978), aff'd sub nom. Memorex v. International Business Machines Corp., 636 F.2d 1100 (9th Cir. 1980), cert. denied, 452 U.S. 972, 101 S.Ct. 3126, 69 L.Ed.2d 983 (1981) recognized "it is not anticompetitive for a company to reduce prices to meet lower prices already being charged by competitors. Indeed '[t]o force a company to maintain non-competitive prices would be to turn the antitrust laws on their head.'"

This limited exception to the long-run incremental cost test is reasonable. However, when filing tariffs which employ the exception, South Central Bell must provide cost studies and

⁴¹ See MCI Brief at 26-30.

⁴² South Central Bell Brief at 10-13.

evidence that competitors have already charged rates below those which would cover its long-run incremental costs.

If the competitive price threat vanishes, South Central Bell must, within 30 days, restore its price to cover its long-run incremental cost.

Changing Service Classifications

South Central Bell proposes that it be allowed to seek Commission approval to reclassify services at any time. The Commission would have 30 days to either approve or suspend the request. Inaction within 30 days would be deemed approval. In the event of suspension, existing law would apply, except that the Commission would have 90 days to complete its investigation. Again, inaction within the allotted time would be deemed approval.⁴³

As a 90-day limitation may constrain a thorough investigation, the Commission will retain its full jurisdiction in these matters.

New Service Pricing

South Central Bell proposed that a new service be defined as a function, feature, capability, facility, or combination of these which had not previously been offered. At least 30 days prior to the introduction of a new service, the Company would provide notice and a tariff setting forth its price, terms, and conditions. Such tariffs would designate a proposed category and provide a rationale for the designation. The new service would become effective

⁴³ Gerwing Testimony Exhibit FLG-1 at 2-3 of 20.

following the notification period.⁴⁴ The Commission could, on its own motion, or on petition, investigate whether the service category was appropriate, whether the service rate met the long-run incremental cost test, and whether the terms and conditions of the new service were in the public interest.

South Central Bell proposes that new service investigations be concluded in 90 days. Absent a Commission Order in the 90-day period, the tariff would be deemed approved. New services would not be postponed or suspended during investigation. If rates were found to be inappropriate, South Central Bell would accept retroactive treatment back to the date the service was offered.⁴⁵

For minor or uncontested tariff offerings, South Central Bell's proposal is reasonable. However, it is unreasonable to expect the Commission to resolve cases involving contentious issues in 90 days. Hence, the Commission will use the full statutory suspension period as needed.

Existing Service Pricing

South Central Bell's proposal to allow individual service price changes to become effective upon 30 days notice should be rejected. In the event of tariff suspension, the Commission's usual procedures should apply. When seeking a specific price change, South Central Bell should file a cost study justifying the

⁴⁴ Id. at 3 of 20.

⁴⁵ Id. at 4 of 20.

tariff change and documentation that the SPI remains below the PRI ceiling for Non-Competitive and Interconnection Services.

RATE REBALANCING

The intervenors would have the Commission revise South Central Bell's rates to eliminate existing subsidies. However, total elimination of all subsidies in rates is not in the public interest at this time. It would have serious detrimental affects on many customers. Further, toll rates have undergone substantial rebalancing as a result of Case No. 90-256⁴⁶ and Administrative Case No. 323.⁴⁷ Service rates in each category will be adjusted in this case. For many services, the market is better suited to determine the degree of rebalancing that should occur. Therefore rate rebalancing across all South Central Bell services is not warranted at this time.

EARNINGS SHARING

An earnings sharing measure has been included in various price cap plans in other states and at the FCC. These plans require the carrier to share earnings with ratepayers above specified levels. South Central Bell did not propose earnings sharing in its plan. MCI suggested that:

. . . a sharing requirement should be included under most alternative regulation plans, especially the South

⁴⁶ Case No. 90-256, A Review of the Rates and Charges and Incentive Regulation Plan of South Central Bell Telephone Company, dated April 3, 1991.

⁴⁷ Administrative Case No. 323, An Inquiry Into Toll Competition, An Appropriate Compensation Scheme for Completion of IntraLATA Calls by Interexchange Carriers, and WATS Jurisdictionality.

Central Bell plan because of the upward pricing flexibility, and the omission of an offsetting productivity factor."⁴⁸

The FCC's most recent Order on price caps set three levels of productivity from which a carrier could select. At the two lower levels, earnings sharing was required. At the highest productivity level, carriers were permitted to retain all earnings. The FCC encouraged carriers to select this level because price cap regulation coupled with earnings sharing creates perverse market incentives and is not in the public interest. BellSouth's subsidiaries chose this productivity level.

Earnings sharing is but another feature included in plans to protect consumers where competitive markets do not exist. In the absence of competition, some measure of performance must be included in a price cap plan to protect ratepayers from South Central Bell's ability to price at levels which produce monopoly profits. To this end, the productivity factor has been established at an achievable level which is nonetheless high enough to provide South Central Bell sufficient incentive to excel. Local residential service and access charges have been capped. With these incentives and protections, earnings sharing would likely undermine South Central Bell's incentive to be as efficient as possible. Efficiency and productivity are to everyone's benefit.

⁴⁸ Klaus Testimony at 13 and 14.

QUALITY OF SERVICE

Under any form of alternative regulation, there is a greater potential for service to decline. When a company is no longer assured a return on investments made to maintain quality service, it may be tempted to forego the effort and maximize its profits. Under its previous incentive plan, South Central Bell's service did not decline and it must not in the future.

Under price caps and with increasing competition, there could be even more incentive for a company to reduce service standards. Some states have added a service penalty to avoid this. These penalties are generally in the form of an "increase" of approximately .5 percent to the productivity offset.

Pursuant to 807 KAR 5:061, South Central Bell submits to the Commission a summary of monthly service objective records, by district, which monitor various criteria which measure the adequacy of service. If the Company's performance falls below minimum service objectives for two consecutive months, it is required to report the action taken or planned to correct the problem. This focuses capital and attention on the problem as opposed to a service penalty which is non-specific. This approach is more likely to ensure continued high service quality than the penalty approach.

To assist the Commission in this process, South Central Bell's summary of monthly service objective records should identify exchanges that do not meet the established minimum service objectives for any month, regardless of the associated district's

performance. In addition, if performance levels for any exchange fall below the minimum service objectives for two consecutive months, South Central Bell should submit a report setting forth the specific action taken or planned to correct its performance. Last, but not least, the Commission's own Consumer Services Branch should recognize any deterioration of service quality.

DEPRECIATION

As in the other features of its plan, South Central Bell requests maximum flexibility on depreciation. It argues that the plan places the Company's risk clearly on the shareholders and that depreciation decisions should likewise be in their hands. As with other aspects of the plan, this level of flexibility poses certain dangers to captive ratepayers.

Generally, South Central Bell should be allowed to make its own decisions concerning depreciation. However, effective competition does not yet exist in many markets and captive ratepayers should not bear increased burdens due to increased flexibility. South Central Bell must still make periodic depreciation filings with the FCC and should provide the Commission with copies. In this manner, the Commission can track South Central Bell's depreciation decisions and interact with the FCC to ensure that assets are depreciated in a timely and reasonable manner. This process should not impose any undue competitive hardship on the Company.

INVESTMENT AND EXTERNAL EVENTS

The Commission has considered two other features present in other price cap plans.

Some states have set requirements for new investment in plant and facilities. However, market forces, the service requirements, and the productivity factor in the adopted plan are sufficient to encourage prudent investment.

Some plans also address external events outside management's control in their pricing formulas. Again, the productivity and inflation factors of the adopted plan are more likely to incorporate the effects of short term changes externally imposed.

DURATION AND ADJUSTMENT OF THE PRODUCTIVITY OFFSET

South Central Bell proposed and the Commission agrees that the price cap plan should not have a set termination date. Even though intervenors argued to the contrary, the plan is, by its nature, designed to achieve long-range goals and objectives. Productivity changes are incremental and should not be viewed from a short-term perspective. If conditions warrant, the Commission retains full jurisdiction to see that any and all necessary changes are made.

In four years from the date of this Order, following the management audit described below, the Commission will require South Central Bell to file a case in which its productivity factor will be reviewed. At that time South Central Bell should provide the results of its productivity analyses over the four-year period and projections for any changes in the factors of production in the

future. Interested parties are invited to participate in these proceedings.

FOCUSED MANAGEMENT AUDIT

It is reasonable to expect that profound changes will occur in the way South Central Bell manages its business due to the increased profit incentives now available to it. To ensure that these changes are in the public interest, South Central Bell should undergo a focused management audit pursuant to KRS 278.255. The audit should be performed in the fourth year after the date of this Order before the Commission's re-evaluation of productivity factors at the end of that year so that the Commission can consider possible changes suggested by the results. The audit should review South Central Bell's investment decisions, service levels, and financial performance under price regulation to determine if adequate service has been maintained. It should also examine South Central Bell's productivity trends, assess the competitive environment in Kentucky at that time, and evaluate South Central Bell's response in terms of its strategic, network, marketing, and operational plans and decisions.

FINANCIAL MONITORING REQUIREMENTS

Under incentive regulation, South Central Bell has submitted a substantial amount of financial information to assist the Commission in monitoring its operations and evaluating its points-of-test. These reports are not necessary under a price regulation plan. However, South Central Bell should file routine quarterly and annual financial reports. The Company may produce income

statements in accordance with Generally Accepted Accounting Principles ("GAAP"), but should maintain current USoA accounts and structure. South Central Bell should continue to be accessible and accountable for reporting on normal regulatory issues, but quarterly meetings are unnecessary. Finally, it should provide biennial reviews of its progress toward price regulation objectives, including a customer satisfaction analysis and technology assessment.

INITIAL REVENUE AND RATE REDUCTION

The initial revenue and rate reduction under the plan is described in full below.

Test Period

By Order dated May 11, 1994, the Commission determined that, in light of South Central Bell's proposal to phase out touch-tone charges and reduce intrastate access charges, it would be appropriate to establish the Company's current financial condition based upon a test period. In the absence of a proposed test period, the Commission found that the calendar year 1993, or some subsequent 12-month period, would be appropriate and required South Central Bell to file financial information accordingly. The Company chose the 1993 calendar year which has been used by the Commission in this proceeding.

Net Investment Rate Base

The AG has proposed a net investment rate base of \$750,863,197. South Central Bell argued that return on capital ("ROC") was the appropriate basis. The Commission, in Case No.

10105,⁴⁹ adopted South Central Bell's proposal to use ROC to determine the appropriate level of net operating income and reaffirmed this decision in Case No. 90-256. As the continued use of ROC was not challenged in this proceeding and remains reasonable, the Commission will use the Company's December 31, 1993 intrastate capital amount of \$755,991,743 as shown in Schedule 2 of its monthly surveillance report filed on March 11, 1994.⁵⁰

Cost of Capital

The AG recommended using a return on equity of 11.6 percent to determine a starting point for rates under any method of regulation. He determined South Central Bell's cost of equity using an annual Discounted Cash Flow ("DCF") model which yielded a range of 11.6 percent to 12.1 percent. On rebuttal, South Central Bell stated that its cost of equity is 14.0 percent, selected from a range of 13.8 percent to 14.5 percent based on a quarterly DCF model and the Risk Premium approach. It challenged the AG's use of the annual DCF model and the growth component used in his analysis.

The Commission accepts the annual DCF model because the quarterly DCF model, like the risk premium approach, overstates the required cost of equity. However, the AG has incorrectly applied the model and understated South Central Bell's required return on equity. The upper end of its recommended range, however, provides

⁴⁹ Case No. 10105, Investigation of the Kentucky Intrastate Rates of South Central Bell Telephone Company, Inc., dated September 30, 1988.

⁵⁰ Case No. 90-256.

a reasonable starting point for an appropriate return range for equity capital. Based on the record and current economic conditions, a return on common equity in the range of 12.1 percent to 12.9 percent is fair, just, and reasonable. A return of 12.5 percent should be used to establish South Central Bell's initial rates. This return will best meet the objective of allowing South Central Bell to provide for necessary expansion to meet future service requirements at the lowest possible cost to ratepayers.

Applying South Central Bell's actual cost of debt and a rate of 12.1 percent to 12.9 percent for common equity to its actual capital structure produces an overall cost of capital in the range of 10.0 to 10.49 percent which is fair, just, and reasonable.

Revenues and Expenses

South Central Bell reported net operating income of \$82,574,175 and increased this amount to \$91,064,902⁵¹ to recognize regulatory adjustments required by the Commission and to include certain nonrecurring and out of period items in the test period.

The adjusted revenues and expenses proposed by the Company are acceptable for rate-making purposes with the following modifications:

⁵¹ South Central Bell originally reported \$91,076,386 in its response to the Commission's Order dated July 5, 1994, Item 40(b). In response to oral requests at the hearing, the Company filed a correction to the amount of contributions removed from Net Operating Income. This adjustment decreased Net Operating Revenue by \$11,484, resulting in an adjusted Net Operating Income of \$91,064,902.

Deferred Revenue. In Case No. 90-256, the Commission required South Central Bell to defer revenues to recognize its reduced revenue requirement resulting when its obligation to amortize inside wire maintenance expired. Subsequently, the Company made monthly entries of \$669,750 (\$8,037,000 annually) to reverse and recognize the amounts previously deferred, resulting in a corresponding reduction in its revenue requirement. This monthly amortization ended in February 1995.

The AG proposed to reduce intrastate revenues by this amount as it is inappropriate to establish future rates based on these revenues. Although the Commission on occasion allows adjustments to a test year for events subsequent to it, the fact that the event occurred 14 months after the test period counsels against doing so in this instance.

Revenue Normalization. The AG recommended that local service revenues be normalized to the end of the test period by analyzing Account 5060 - Other Local Exchange Revenue, thus increasing total revenues by \$3,933,165. This account includes enhanced services such as call waiting, call forwarding, and customized dialing features, which according to the AG will continue to grow either as a result of substantial Company advertising or customer needs. This adjustment is consistent with sound regulatory policy and is appropriate because year end capital is used to determine revenue requirements.

Inside Wire Maintenance. The AG recommended that \$1,000,000 of net revenues be imputed to recognize profits realized by South

Central Bell from inside wire maintenance contracts. The Commission is authorized to do so by FCC Docket 79-105.⁵² The AG opines that the sale of inside wire maintenance agreements is profitable and that South Central Bell has significant advantages over potential competitors in marketing these plans.

South Central Bell argues that the adjustment is inappropriate and arbitrary and based on evidence of record concerning installation and maintenance activities which, when combined, are not profitable. The Company also states that its cost allocations do not differentiate between installation and maintenance.

The arguments on this issue are substantially the same as those presented in Case No. 94-355⁵³ where the Commission recognized that inside wire maintenance contracts were not subject to effective competition and that Cincinnati Bell enjoyed significant competitive advantages which other providers could not duplicate from a practical or financial standpoint. The Commission is not convinced that South Central Bell's contracts are unprofitable but has made the Company a party to the rehearing of Case No. 94-355 in which this issue will be further investigated. The adjustment should be deferred pending a decision in that case.

⁵² FCC Docket 79-105, Detariffing the Installation And Maintenance of Inside Wiring.

⁵³ Case No. 94-355, Application of Cincinnati Bell Telephone Company for Authority to Increase and Adjust Its Rates and Charges and to Change Regulations and Practices Affecting the Same.

Directory Revenue. The Commission has historically required South Central Bell to book imputed revenues to its Yellow Pages advertising account to adjust the earned rate of return of BellSouth Advertising and Publishing Company ("BAPCO") to the level allowed South Central Bell by the Commission. The AG proposes to further increase the Yellow Pages imputation to capture what he considers excessive returns earned by two affiliated companies which supply services to BAPCO. The AG presumes that any excessive profits earned by those companies are reflected in excessive prices charged to BAPCO and that they realize higher profit margins from BAPCO than from other customers. The proposed net operating income adjustment is \$633,348 or \$1,061,997 in revenue. The Company opposed the adjustment as inappropriate because both companies have significant other markets in which rates comparable to those paid by BAPCO are charged.

The potential cross subsidization of nonregulated entities by regulated affiliates is a real concern. However, it is less likely to occur when markets and market prices have been established by the nonregulated entities. Under the affiliated transaction rules established by the FCC in Part 32,⁵⁴ a prevailing market price is one of the criteria used to record sales from nonregulated entities to regulated affiliates. There is no evidence in the record to indicate that these companies charge BAPCO prices different than

⁵⁴ Part 32, Uniform System of Accounts For Telecommunications Companies

those charged other customers or that the market share of the companies was not adequate to establish a market price.

Universal Service Fund Contribution. The AG proposed to reduce net operating income, after taxes, by \$441,360 to recognize that the Company would not receive universal service fund revenues in 1994 as it had in 1993. South Central Bell opposes the adjustment as one-sided and selectively chosen to have a positive impact on test period net operating income.

The adjustment should be accepted. Known and measurable changes occurring in a reasonably short time after the test period are appropriate for rate-making purposes and an event which begins one day after the end of the test period can be characterized as happening in a reasonable time frame following the test period.

Other Revenues. The AG also proposed to increase test period revenues in the amount of \$102,213 to recognize revenues recorded in 1994 which were applicable to 1993. The Company again opposed the adjustment as one sided. The AG's proposal correctly adjusts the test period for revenues applicable to but recorded outside of the test period and should be accepted.

Pro Forma Wage Adjustment. The Company annualized the test period to reflect a base salary increase effective in March 1993 and an increase for non-management employees effective in August 1993. The total adjustment was \$1,258,406.

The AG determined that total wage and salary expense for 1994 was less than 1993. He concluded, and the Commission agrees, that the increased compensation levels had been offset by decreases in

the workforce and that an adjustment for increased wages was therefore unnecessary to reflect future wages.

Incentive Compensation. The AG proposed to remove 50 percent of the incentive compensation or \$3,385,239 from test year expenses because it is pay above and beyond the employees' normal base salary benefits which are funded by the ratepayer. He chose to remove only 50 percent because employees had recently been receiving lower wage increases which in some cases did not keep pace with inflation.

The incentive program for non-management employees is determined by contract and is related in part to meeting customer satisfaction, quality of service, and cost control goals. For management employees, the TEAM award program places a designated percentage of base salary at risk, with receipt contingent on the Company meeting these goals. The Company also notes that base salary increases in recent years have been modest.

Incentive plans vary and in some cases may not be appropriately included in the cost of service. However, that is not the case in this instance. The non-management plan clearly constitutes a part of the "normal" pay. The smaller base salary increases and the fact that some of the compensation associated with the plan is at risk support including the incentive payments in South Central Bell's expenses.

Pension Expense. South Central Bell reported a Kentucky jurisdictional pension expense of \$3,631,905 for 1993. The AG proposes to reduce this expense to zero stating that the Company

does not intend to fund the plan at least through the year 2000.⁵⁵ The AG argues that at the very least pension expense should be reduced by \$2,196,305 because the Company converted its plan to a cash balance plan in 1994⁵⁶ reducing pension expense for that year. As South Central Bell has not shown why an adjustment for the conversion would not be reasonable, the Commission will accept the adjustment of \$2,196,305.

Supplemental Executive Retirement Plan Expense. The AG also recommends disallowance of the allocated Supplemental Executive Retirement Plan ("SERP") expense of \$133,127 because this expense is related to an additional pension plan for the highest paid executives in the Company. The Company argues that the SERP makes pension benefits for managers comparable to those available to other employees. The Commission has consistently disallowed expenses related to supplemental executive retirement plans because they exceed base benefits for which ratepayers should be responsible and will allow the expense reduction.⁵⁷

Other Operating Income and Expense. The AG seeks to reduce test-year expense by \$253,252 to disallow from the cost of service Abandoned Projects in the amount of \$81,590, Allowance for Funds Used During Construction ("AFUDC") in the amount of \$247,829,

⁵⁵ Thomas C. DeWard Supplemental Testimony dated March 21, 1995 at 41-42.

⁵⁶ Id., page 44.

⁵⁷ See, for instance Case No. 90-158, Adjustment of Gas and Electric Rates of Louisville Gas and Electric Company and Case No. 94-355.

Other Operating Income and Expense in the amount of \$29,539, and BellCore Income in the amount of \$170,240. He would remove each of these expenses because they relate to unregulated activities.

Upon review of each item, the Commission finds that each relates to a regulated activity and the expenses should be included.

White Pages Expense. The AG recommended reducing South Central Bell's cost of service by \$1,000,000 by shifting the costs of producing, printing, and distributing White Pages to the interstate jurisdiction. While these costs are recorded on BAPCO's books and a portion continues to be allocated to the interstate jurisdiction, the AG argues that a much larger share of expense would have been allocated to the interstate jurisdiction had the company not entered into an arrangement with BAPCO. According to the AG, net operating income for the intrastate jurisdiction would have been increased if the costs had been allocated to the interstate jurisdiction as South Central Bell had done prior to the BAPCO agreement.

The costs to publish and distribute the White Pages directories are a part of the cost structure of BAPCO and are not included in test period expenses. Imputation under these circumstances would be proper only if all expenses associated with the publication of the White Pages were imputed to South Central Bell. The adjustment should be rejected.

Environmental Accrual. The AG recommends that the test period expense associated with fuel tank compliance and superfund accruals should be reduced by \$333,594 to equal 1994 accruals, even though he agrees that the accruals are not necessarily indicative of actual expense. The actual expense may in fact be significantly different than the accruals. This adjustment should be rejected.

Depreciation Expense. The AG recommends increasing the depreciation expense for the test year by \$2,301,371 to allow the Company to depreciate plant additions added throughout the test year. The Company argues that the adjustment is one-sided, albeit in its favor. It is appropriate to recognize year-end depreciation levels when using end-of-period capital or rate base and normalizing the test period for revenue and expense changes during the period. By doing so, test year expenses, revenues, and investment are matched. This adjustment should be allowed.

Amortization Expense. The AG proposes to remove two amortization expenses. The first, which the Commission rejects, in the amount of \$1,097,024, relates to compensated absences. The AG suggests that the Company should follow the accounting treatment prescribed by SFAS 43 in 1980.

In 1980 the Company followed Part 31 accounting procedures as prescribed by the FCC. In 1987 the FCC adopted Part 32 which was also adopted by this Commission. The Company's current treatment for compensated absences is in accordance with Part 32 rules.

The AG's second proposal, which the Commission allows, deals with deferred equal access costs and totals \$115,096. The

amortization of those costs expired in 1993 and should not be included in determining the future cost of service.

Miscellaneous Expenses. Expense reductions of \$25,209 for spousal travel and personal tax and financial planning and \$9,854 in external relations expense are consistent with many prior rulings of the Commission and will be accepted.

The AG also proposed a \$8,288 reduction for dues paid to telecommunications associations. South Central Bell notes that 30 percent of these dues are already recorded below the line and that the AG's 50 percent disallowance has no basis.

The Company has already allocated 30 percent of the USTA dues below the line, an amount that appears reasonable in the absence of evidence to the contrary. As trade association dues are an acceptable cost of service which provide benefit to the Company, the adjustment should be denied.

The AG's proposal to remove from expense numerous items that total \$171,241 and relate to payments made to other trade, technical, professional and other non-company organizations should be accepted. Payments in support of these endeavors are appropriately borne by the stockholders. A \$6,400 charge related to the Atlanta Golf Classic and \$52,370 for miscellaneous items including subscriptions should also be removed.

BellSouth Voucher Charges. The AG proposed to remove from operating expense \$530,573 allocated to South Central Bell from BellSouth Telephone incurred for a National Press Club Dinner, sponsorship of Forward Atlanta, the BellSouth Classic Golf, and a

special assessment for the President's Retirement Package for USTA. The AG also excluded several large payments for furniture arguing they should be capitalized. Relating to the furniture, the Company explained that it had followed Part 32 accounting rules. The Commission agrees with the Company's interpretation of Part 32, and will not require an adjustment for the furniture cost. The adjustment for the remaining expenses will be \$469,661.

BellSouth Systems Sales Commissions. The AG proposed an adjustment of \$306,955 for payments made to BellSouth Business Systems because average billings declined from 3.8 percent in 1993 to 2.8 percent in 1994. As the 1994 figure is an estimate and the actual amount could differ, the adjustment is rejected.

BellSouth Corporate Charges. BellSouth Corporation, the parent company of BellSouth Telecommunications, Inc., ("BellSouth"), passes many of its costs through to its subsidiaries. The AG reviewed BellSouth's trial balance for the test period and proposes to remove \$557,867 in expenses. The list includes 14 items including "Management Salary - Special Payments," "Team Executive Award - Managers," "Market Advertising/Publicity," "Employee Business Expense - Entertainment," "Sponsorships," and "Unusual or Infrequent Expenses."

The Commission, supra, allowed incentive award payments. The Team Executive Award-Managers in the amount of \$55,721 and the Non-Management Team Incentive Award in the amount of \$1,386 will be allowed as cost-of-service items.

The remaining \$500,760 of expenses are the types of expenses historically excluded from the cost of service by the Commission as appropriately borne by shareholders.

IntraCompany Investment Compensation. South Central Bell receives products and services from affiliated companies located in other states. Through the IntraCompany Investment Compensation ("ICIC") process, the provider will receive from the recipient an amount representing a return on the provider's investment dedicated to providing service. This avoids having the total investment recovered from the jurisdiction in which the provider is located when services benefit numerous jurisdictions.

The AG proposes to decrease operating expenses by \$750,000 to recognize excess charges allocated to Kentucky under this arrangement. He postulates that Kentucky is being billed excessive returns on assets located in other jurisdictions but cannot support this position, alleging that adequate information to analyze the charges properly was not provided. South Central Bell argues that the disallowance is arbitrary and notes that, in more than 600 data requests, the AG did not ask about ICIC.

The potential for cross subsidization of non-regulated affiliates by jurisdictional utilities is a real threat. However, the FCC's affiliated transaction rules, cost allocation manual, and audits provide some protection against cross subsidies. The Alabama and Tennessee commissions have also found that the ICIC operates properly. Absent evidence to the contrary, this adjustment should be denied.

Interest on Customer Deposits. The AG included \$75,029 of interest on customer deposits in the Company's cost of service based upon his proposed removal of customer deposits from rate base. The Commission has, supra, reaffirmed use of capital to determine the proper level of earnings for South Central Bell. By doing so, the need to impute interest on customer deposits to cost of service is avoided.

Federal Tax. The AG recomputed the test period federal income tax liability using booked revenues, expenses, and taxes, and recommended a reduction of \$1,212,351 from the booked amount. However, he provided no evidence that the Company's booked federal income tax liability is computed incorrectly. He presumes that part of the difference is due to an out-of-period adjustment to the booked amount which the Company made to arrive at the adjusted net operating income it considers appropriate for the test period.

There is no evidence that the Company's booked federal income tax liability is inappropriate, especially in view of the fact that South Central Bell has removed an out of period adjustment of \$699,225 in calculating the amount.

Employee Stock Ownership Plan. The AG proposes to reduce federal income tax expense by \$591,105 to recognize a portion of the tax benefit BSC received for dividends paid on stock held by its Employee Stock Ownership Plan ("ESOP"). He states that ratepayers are responsible for the cost of the plan through the employer's share and therefore a portion of the tax savings should be allocated to the subsidiaries of BSC. The Company argues that

the dividends paid to the ESOP are a cost to BSC and that it is this cost, not the expense to the subsidiaries, which results in the tax savings. Therefore, none of the tax savings should be allocated to the subsidiaries.

There is no justification for departing from fundamental rate-making principles which hold that the tax results of the non-utility revenues and expenses should not be considered when setting utility rates.

Employee Concession Service. The AG recommends that revenues lost on concession telephone service for employees should be imputed without consideration of income tax impacts because merely imputing the revenues does not create taxable income to the recipient. South Central Bell argues that allowances and disallowances are computed to include the tax effect that would exist if the Company's books were kept in accordance with the adjustment.

The Commission has historically computed income tax impacts of revenue imputations including those for Yellow Pages revenue and end-of-period adjustments. The record is devoid of evidence that concession service should be treated differently.

Research and Experimental Tax Credit. In 1994, the Company recorded a tax credit of \$277,655 representing its allocated portion of research and experimental tax credits attributable to the 1993 tax year. The AG recommended an adjustment to recognize this credit arguing that ratepayers, who pay for research and

development, should receive the tax benefit generated by these expenditures.

Items attributable to a test period but recorded outside it should be recognized to reflect correctly the cost of service of the test period. The adjustment should be allowed.

Gross Revenue Conversion Factor. The Commission has computed the gross revenue conversion factor to be 1.693⁵⁸ using booked uncollectible accounts for the test period.

REVENUE REQUIREMENTS SUMMARY

Based on South Central Bell's adjusted operating income, the Commission has determined that its revenues should be reduced by \$28,931,541, determined as follows:

Required Net Operating Income	\$77,791,550
Adjusted Net Operating Income	<u>94,880,470</u>
NOI Sufficiency	17,088,920
Multiplier	<u>x 1.6930</u>
Revenue Sufficiency	<u>\$28,931,541</u>
	<u>or \$28.9 million</u>

⁵⁸ Revenues	1.0000
Uncollectible Accounts	<u>< .0099 ></u>
	.9901
State Tax @ 8.25%	<u>< .0817 ></u>
	.9084
Fed Tax @ 35%	<u>< .3179 ></u>
	.5905

$$1.000 + .5905 = 1.693$$

RATE DESIGN

South Central Bell proposed to reduce access charges by approximately \$10 million to match its interstate rates as of December, 1994 and maintain those rates until May 1997. Reductions in carrier common line charges, i.e., non-traffic sensitive revenue requirements, are included. Also, the Company proposed to reduce residential touch-tone charges in three installments by approximately \$4 million in each of the years 1995, 1997, and 1999. The total proposed rate reductions were approximately \$22 million.

The Company provided revenue impact estimates for rate reductions listed as priorities under its former Incentive Regulation Plan,⁵⁹ including business grouping service and zone charges.

The Commission has generally encouraged mirroring interstate switched and special access charges. There is no evidence that the cost of interstate and intrastate access services are substantially different. Also, mirroring tends to discourage "tariff shopping" by an interexchange carrier which subscribes to the least expensive tariff, irrespective of its actual jurisdictional usage.

For these reasons, South Central Bell's proposal to mirror its interstate access charges should be accepted as proposed. The record indicates that this will require a reduction of approximately \$9.9 million.⁶⁰ As a reduction of \$724,000 was

⁵⁹ Response to Commission Order dated July 5, 1994, Item 26.

⁶⁰ Id., Item 53.

authorized in Case No. 95-015,⁶¹ the total should be reduced to approximately \$9.2 million, apportioned to mirror interstate access charges. South Central Bell should file revised access services and associated tariffs within 30 days from the date of this Order and provide supporting price-out documentation.

In Case No. 90-256, the Commission established a ratio of 1:14 between reductions in the non-traffic sensitive revenue requirement and long distance rates. For the reasons stated in that case, message toll rates should be reduced approximately \$1.3 million. South Central Bell should propose appropriate rates in a tariff filing and provide supporting price-out documentation within 30 days from the date of this Order.

The Commission considers reductions in zone charges a high priority. They represent a barrier to service in rural areas and impede rural economic development. South Central Bell estimates that reducing band zone charges to two-party levels would require approximately \$12 million.⁶² Based on other information, it appears that the correct estimate is approximately \$6.2 million.⁶³ Of the zone charges, those for the bands 4 and 5, which encompass areas farthest removed from the central office, impose the greatest

⁶¹ Case No. 95-015, The Tariff Filing of South Central Bell Telephone Company to Introduce an Additional Charge Associated With Certain Calls Made From BellSouth Telecommunications Public and Semi-Public Calling Stations.

⁶² Response to Commission Order dated July 5, 1994, Item 26.

⁶³ South Central Bell's response to Commission hearing request dated June 2, 1995, Item 4.

burden. To consolidate both to the band zone 3 level will require an additional \$2.6 million reduction to zone charges. To further stimulate economic development in rural areas, the total authorized reduction is \$8.8 million, which reduces revenue from zone charges by approximately 45 percent.

The zone charges specified in Appendix B reduce rates to 2-party levels and consolidate band zone 4 and 5 rates with band zone 3 rates. South Central Bell should file revised tariff pages within 30 days of the date of this Order.

Currently, grouping charges are assessed at 55 percent of the applicable individual line flat rate. South Central Bell suggested in response to an information request⁶⁴ that the charges could be reduced to a statewide flat rate of \$15 with a revenue decrease of approximately \$5.7 million. This estimate also appears to be incorrect. Based on other information, the proposed rate adjustment would require a revenue reduction of \$6.6 million.⁶⁵

Like zone charges, business grouping charges are onerous. They impede the use of a valuable service by discouraging additional access lines. Accordingly, the Commission will authorize a statewide business grouping charge of \$15.85 and eliminate residence grouping charges. The total revenue reduction to grouping charges is \$5.9 million.

⁶⁴ Response to Commission Order dated July 5, 1994, Item 26.

⁶⁵ South Central Bell's response to Commission hearing request dated June 2, 1995, Item 4.

Revised grouping rates are specified in Appendix B. South Central Bell should file revised tariff pages within 30 days of the date of this Order.

South Central Bell's proposed reductions would have completely eliminated residential touch tone rates. However, complete elimination of residential touch tone charges for the Company would reduce reductions ordered for access, toll, zone charges and grouping charges.

The Commission will authorize a single reduction to residence touch tone charges of \$3.7 million which will reduce the current \$1.50 per month charge to \$1.00.⁶⁶ South Central Bell should file revised tariff pages within 30 days from the date of this order consistent with Appendix B.

ORDERS

The Commission, having considered the application of South Central Bell for price cap regulation and all evidence of record and having been otherwise sufficiently advised, HEREBY ORDERS that:

1. Price cap regulation for South Central Bell shall be adopted with the modifications ordered herein.

2. Within 30 days of the date of this Order, South Central Bell shall file tariff sheets containing the modified price cap regulation plan.

⁶⁶ Id.

3. The fair, just, and reasonable rate of return on equity shall be in the range of 12.1 percent to 12.9 percent, with 12.5 percent used to establish rates.

4. South Central Bell shall reduce its revenues by \$28.9 million.

5. The services of South Central Bell shall be classified in the three categories contained in Appendix A attached hereto.

6. Local residential rates shall be capped at current levels for a minimum of three years from the date of this Order and thereafter until a viable universal service plan applicable to Kentucky is implemented.

7. A productivity factor of 4 percent shall be part of the formula in pricing Non-Competitive services. Inflation shall be as measured in the fourth quarter of each year by the United States Department of Commerce GDP-PI.

8. South Central Bell shall make an annual filing on July 1 to be effective August 1 to recalibrate the PRI and to provide a price-out of all services.

9. The annual price increase of an individual service in the Non-Competitive Service category shall not exceed 10 percent.

10. Switched access rates shall be limited to the FCC's interstate rates. For services for which there is no interstate counterpart the pricing formulas set out in the Non-Competitive category shall apply.

11. There shall be no limit on price changes for competitive category services except long-run incremental cost constraints.

12. South Central Bell may lower its prices below LRIC only to respond to an equally low price of a competitor. South Central Bell shall provide evidence of the competitor's price and, if this competitive price threat vanishes, South Central Bell shall, within 30 days, restore its price to cover its LRIC.

13. South Central Bell shall provide cost studies to support all tariff changes and new services.

14. South Central Bell may reclassify a service or propose a new service on 30 days notice to the Commission, subject to KRS 278.190.

15. To change the price of an existing service within the parameters of this price cap plan, South Central Bell shall file, with 30 days notice to the Commission subject to KRS 278.190, documentation that the SPI remains within the PRI ceiling for the relevant services.

16. South Central Bell's summary of monthly service objective records shall be expanded to include any exchanges, listed separately, that do not meet the established minimum service objectives for any month. If performance levels for any exchange fall below the minimum service objectives for two consecutive months, South Central Bell shall submit a report of the specific action taken or planned to correct the performance levels.

17. South Central Bell may establish depreciation rates at its discretion. The Commission shall continue to participate in the depreciation process and South Central Bell shall file, with

the Commission, copies of all its depreciation filings submitted to the FCC.

18. Within four years of the date of this Order, South Central Bell shall file a case in which its productivity factor will be reviewed. It shall provide a productivity analysis and projections for any changes in the factors of production.

19. Within the fourth year from the date of this Order, South Central Bell shall undergo a focused management audit.

20. South Central Bell shall file quarterly and annual financial reports and a biennial review of its progress toward price regulation objectives.

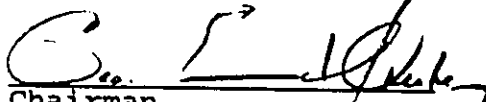
21. The determination of the regulatory status of inside wire maintenance programs shall be made in the rehearing proceeding of Cincinnati Bell's case, Case No. 94-355.

22. Within 30 days of the date of this Order, South Central Bell shall file tariffs to reduce access charges by \$9.2 million, long distance toll by \$1.3 million, zone charges by \$8.8 million, grouping charges by \$5.9 million, and residential touch tone by \$3.7 million as contained in Appendix B, attached hereto and

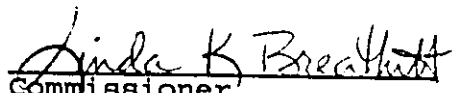
incorporated herein. South Central Bell shall supply specific rates for access charges and toll services.

Done at Frankfort, Kentucky, this 20th day of July, 1995.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 94-121 DATED JULY 20, 1995.

NON-COMPETITIVE SERVICE CATEGORY

Additional Listing
Announcement Facilities
Answer Supervision
Area Number Calling Service
Automatic Number Identification
Back-up Line
Call Detail Information
Central Office Concentrator Service
Charges for Unusual Installation
Conduit Occupancy
Custom Calling Services
Custom Service Area (CSA)
Directory Assistance (Local)
Directory Assistance Call Completion
Directory Assistance Database Services/Data
 Publishers Database Service
Directory Assistance - Intra NPA Long Distance
 Directory Assistance
Dual Service
Electronic White Pages
Emergency Reporting Services
Extension Service (Channels for) and Tie Lines
Foreign Central Office Service
Foreign Exchange Service
Grouping Service
High Voltage Protection
Integration Plus Management Service (IPMS) (FlexServ, NUIS)
IntraLATA Long Distance Operator
 Verification/Interruption Service
ISDN Individual Services - Residential and Business
Joint User Service
Late Payments
Local Exceptions
Local Operator Verification/Interrupt
Message Waiting Indication - Audible (MWI)
Miscellaneous Listing
Multifeature Discount Plan
NAR ESSX-1
Network Access Register Package
Network Interface Equipment
Non-Competitive Service Connection Charges
Non-Published (Private) Listing
Non-Published (Semi-Private) Listing
Pole and Anchor Attachments

Premises Work Charges
Premises Work Charges - Complex Residence and Business
Public Telephone Service
Residential State Wide Rate Schedule (Measured,
Message, and ACS)
Route Diversity and Avoidance
Selective Class of Call Screening Service
Semi-Public Telephone Service-Access Line Only
Service Expediting Charge
Special Number Acquisition Charge
Special Service Arrangements
State Wide Rate Schedule (Business Flat, Measured,
Message, and ACS)
Telecommunication Service Priority (TSP) System
Telephone Answering Service Facilities
Toll Restriction (Battery Reversal in C.O.)
Touch-Tone Calling Service
TouchStar Service
Trouble Determination Charge
Trunk Lines
Trunk Side Access Facility - Local Exchange Service
Uniform Access Number (UAN)
Volume Usage Measured Rate Service
ZipCONNECT Service
Zone Charges - Business
Zone Charges - Residential

INTERCONNECTION CATEGORY

500 Access Service - Personal Communication Service
Access Line Service for Customer Provided Telephone
BNA for ANI
Carrier Common Line Access Services
Common Switching Optional Features
Custom Network Service
Customer List Service
Dedicated Network Access Lines
DID/DOD With LSBSA
Digital Data Access Service
Directory Assistance Access Service
Engineering and Miscellaneous Services
High Capacity
Interconnection for Mobile Services
Line Side Basic Serving Arrangements (LSBSA)
Local Switching
Network Blocking for Feature Group D
Operator Services Access Service
Shared Network Arrangement
Sharing and Resale of Basic Local Exchange Service
Smartline (SM) for COCOT Subscribers
Special Access Services

Switched Access Basic Service Elements (BSEs)
Switched Access Service (Non-BSE)
Switched Transport

COMPETITIVE SERVICE CATEGORY

911 Emergency System Equipment
AccuPulse Service
Addition of Blocking Options to ESSX and Digital ESSX Tariffs
Administrative Management Service
Advanced Private Line Termination Unit ESSX
Area Communication Service
Arrangements for Night, Sunday, Holiday Service
Billing and Collections Services
Break in Rotary Number Group
Coinless Commercial Credit Card Service
Commercial Quality Video
Conference Service
Customized Code Restrictions
Data Transport Access Channel Service
Derived Data Channel Service
Digital Electronic Tandem Switching Features
Digital ESSX Service
Direct-Inward Dialing (DID) Service
Electronic Tandem Switching Features
Equipment for Disabled Customers
ESSX Service
ESSX Multi-Account Service
ESSX ISDN Service
Hot Line Service
Identified-Outward Dialing (IOD) PBX (Systems)
Improved Mobile Telephone Service (IMTS)
Information Delivery Service (976 Dial-It)
Interconnection
Intra NPA LD Operator Service Requiring Telephone
 Number Assistance
Intro Native Mode LAN Interconnection Service
Introduction of Two-Way WATSSaver and Two-Way Aggregated Plans
LightGate Service
Line Out Service Feature
MegaLink ISDN Service
MegaLink Service
MegaLink Channel Service
Multi Station 1 Way Circuit Arrangement for Community Dial O
Multiline Hunt Queuing
Network Access Terminals
Obsolete Telephone Answering
Operator Assisted Calls (Local Operator and
 Calling Card Services)
Optional Calling Plans
Prestige Communications Service (PCS)
Private Line Channels Payment Arrangements

Private Line Sampling Arrangements
Public/Semi Public Message Charges
PulseLink Public Packet Switching (PPSN) Network Service
Remote Call Forwarding Service
RingMaster Service
Service Connection Charges - Competitive Services
Simplified Message Desk Interface (SMDI)
Surrogate Client Number
SynchroNet Service
Toll Trunks (Toll Terminals)
Two-Point Service (Long Distance Message
Telecommunications Service)
Voice Grade/Sub-Voice Grade/Wired Music
Service/Commercial Quality Video
Warm Line Service
Wide Area Telecommunications Service

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN
CASE NO. 94-121 DATED JULY 20, 1995.

The following rates and charges are prescribed for the customers in the area served by South Central Bell Telephone Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order, except as otherwise allowed.

South Central Bell Telephone Company

General Subscriber Services Tariff

A3 Basic Local Exchange Service

A3.9 Zone Charges for Local Exchange Service Outside the Base Rate Area

A3.9.2 Band Zone Charges

A. The following zone charges apply in all exchanges or Locality Rate Areas (unless excepted in A3.7 preceding) in connection with service located outside the Base Rate Areas of exchanges or Locality Rate Areas but within the exchange or Locality Rate Area and are in addition to the basic rate for service. Exchanges or Locality Rate Areas excepted in A3.7 preceding carry zone rates shown in A3.93 following.

1. Up to and including one mile, airline measurement, from the nearest point on the Base Rate Area boundary:

Monthly Rate

- | | |
|--|---------|
| (a) Individual Line, each | \$ 1.30 |
| (b) Private Branch Exchange Trunk Line, each | 1.30 |
| (c) (Obsoleted, see Section A103) | - |

2. Beyond one mile up to and including two miles, airline measurement, from the nearest point on the Base Rate Area boundary:

Monthly Rate

- | | |
|--|---------|
| (a) Individual Line, each | \$ 2.60 |
| (b) Private Branch Exchange Trunk Line, each | 2.60 |
| (c) (Obsoleted, see Section A103) | - |

A3.9.2 Band Zone Charges (continued)

3. Beyond two miles up to and including four miles, airline measurement, from the nearest point on the Base Rate Area boundary:

	Monthly Rate
(a) Individual Line, each	\$ 5.20
(b) Private Branch Exchange Trunk Line, each	5.20
(c) (Obsoleted, see Section A103)	-

4. Beyond four miles up to and including seven miles, airline measurement, from the nearest point on the Base Rate Area boundary:

	Monthly Rate
(a) Individual Line, each	\$ 5.20
(b) Private Branch Exchange Trunk Line, each	5.20
(c) (Obsoleted, see Section A103)	-

5. Beyond seven miles, airline measurement, from the nearest point on the Base Rate Area boundary:

	Monthly Rate
(a) Individual Line, each	\$ 5.20
(b) Private Branch Exchange Trunk Line, each	5.20
(c) (Obsoleted, see Section A103)	-

A3.9.3 Geographic Zone Charges

The following charges apply in lieu of those shown in A3.9.2 preceding in exchanges or Locality Rate Areas designated as exceptions in A3.7 preceding of this Tariff and shown on exchange service area or other maps contained in the Local Exchange Tariff. The following charges apply outside the Base Rate Area in addition to the basic rate for service.

A. Individual Line or Private Branch Exchange Trunk Line, each

	Monthly Rate
1. Zone A	
(a) Residence	\$ 1.30
(b) Business	1.30
2. Zone B	
(a) Residence	2.60
(b) Business	2.60

A3.9.3 Geographic Zone Charges (continued)

Monthly Rate

3. Zone C

(a) Residence	\$ 5.20
(b) Business	5.20

B. (Obsoleted, see Section A103)

A3.19 Grouping Service

A3.19.2 Rates

A. Monthly rates for Grouping Service on individual lines or trunks are as follows:

Monthly Rate

1. Individual line or trunk:

(a) Business Flat Rate, each	
Rate Group 1	\$ 15.46
Rate Groups 2-5	15.85
(b) Business Measured Rate, each	
Rate Group 1	15.46
Rate Groups 2-5	15.85
(c) Business Message Rate, each	
Rate Group 1	15.46
Rate Groups 2-5	15.85
(d) Business Area Calling Service, each	
Rate Group 1	15.46
Rate Groups 2-5	15.85
(e) Residence Flat Rate, each	-
(f) Residence Measured Rate, each	-
(g) Residence Area Calling Service, each	-
(h) Overflow to Back-Up Line, each	
additional non-Area Calling Service	
primary line or hunt group	
Rate Group 1	15.46
Rate Groups 2-5	15.85

A3.19.2 Rates (continued)

(i) Overflow to Back-Up Line from each additional Area Calling Service primary line or hunt group	
Rate Group 1	15.46
Rate Groups 2-5	15.85

A13.2 Touch-Tone Calling Service

A.13.2.3 Rates and Charges

Touch-Tone Calling Service rates and charges shall apply where the customer has the capability to originate calls by means of instruments equipped for tone-type dialing.

The following monthly charges are in addition to any applicable rates and charges for the facilities and service furnished.

A. Individual and Two-Party Line Service

On two-party lines, rate is applicable per subscriber to Touch-Tone service.

	Monthly Rate
1. Per line or PBX trunk	
(a) Residence	\$ 1.00
(b) Business	3.00